THE DEVELOPMENT OF OUR FOREIGN TRADE UNDER THE FEDERAL RESERVE ACT

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The Federal Reserve Act, which was signed by the President on December 23, 1913, and has since become operative by the opening on November 16, 1914, of the Federal reserve banks, has indeed become a powerful force behind the business machinery of our country, and while it may contain possibilities of abuse and misdirected efforts, as a whole it is felt that banks and general business will be benefited in that through able and harmonious action on the part of our financial organizations, we will be in a position to more adequately meet the growing demand for international commerce, and—if our expectations come true—prevent our periodical panics with their demoralizing effect and cessation of business.

Of all the experiences of panics, bitter and costly as some of them have been, perhaps the most effective was the proof it afforded that strength and safety are to be found only in systematic combination. We, in common with other enterprising nations, are approaching the condition of economic maturity.

The question is not now of vital importance whether twelve, eight or only one reserve banking center will bring about the desired result, whether the government or the reserve banks should effect the note issue and thereby provide a more elastic circulating medium to better meet the growing demands of our commerce, and it should therefore be the unbiased aim of all member banks to lend their every support to the new institution which, no doubt, eventually will work out to the benefit of all concerned.

It is necessary, however, for the enterprising banker and business man to move quickly and conform with new conditions in reorganizing former systems to advantageously cope with the present possibilities of broader and better banking.

There are many reasons why the country banker, particularly, should enter upon a broader field of operations. Time alone will prove with what vigorous efforts the larger banks throughout the

country will enter into competition by means of the added facilities afforded them by the National Bank and the Federal Reserve Acts for maintaining branches, and consequent absence of restraint in rivalry for business relations with the smaller banks who, as members and depositors of the federal reserve banks will, in a measure, no longer figure as correspondents and clients with their former restrictive territorial rights.

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and Amendatory thereof and Supplementary thereto reads:

SECTION 5155 (Act March 3, 1865). It shall be lawful for any bank or banking association, organized under State laws, and having branches, the capital being joint and assigned to and used by the mother-bank and branches in definite proportions, to become a national banking association in conformity with existing laws, and to retain and keep in operation its branches, or such one or more of them as it may elect to retain; the amount of the circulation redeemable at the mother-bank, and each branch, to be regulated by the amount of capital assigned to and used by each.

Every financial institution—the small country bank as also the large city bank—will, therefore, readily appreciate the advantage, if not the necessity, of systematically preparing and arranging its organization for the awakening of a more modern banking system, with its equally new and diversified mode of competition.

With the commercial life of a nation, commerce and banking are so closely interwoven that it becomes essential for every person engaged in business to have some knowledge of the part played by these factors. The nature and the use of money, the mechanism of exchange and the development of banking in various parts of the world are features of vital interest to the commercial man. It may not be amiss to here show the successive stages in the evolution of our present-day organized system of banking:

THE FIRST—for obvious reasons to be considered the past—a period of initiative experiments, that of *beginning* and slow but steady growth;

THE SECOND—the present stage of our financial machinery—generally termed a period of *transition;*

THE THIRD—which is still before us—may rightly be designated as the period of *complete maturity.*

Just as conditions differ in the various sections of the United States, so do we find a great diversity in systems and methods of operation in foreign countries. It becomes necessary for us to study these essential requirements in seeking adequate channels for

expansion of our import and export trade and then arrange for the corresponding financial support to establish banking connections to care for and promote the commerce of our financial and business interests.

The world's commerce is almost in its entirety financed by bills of exchange, which in turn act as an index to the value of money. Increased trade—both domestic and foreign—very logically brings about a corresponding demand for credits, and while it may be comparatively easy to create credit, it is often a difficult matter to protect it, which, economically claimed, can only be done by maintaining an adequate amount of gold.

The Federal reserve bank, with its holding of "gold and lawful money" can, for this reason, very effectively find employment of its resources in fostering and rendering assistance in the financing of our trade, as also in the creation of a broader market in foreign centers for the American bank credit, and especially in the recognition of the United States "dollar acceptance."

Under the terms of the Federal Reserve Act a member bank is, under certain conditions, permitted to accept bills of exchange, and, if later required, to negotiate and offer such acceptances for rediscount with the federal reserve bank in the respective district.

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SECTION 13. Any member bank may accept drafts or bills of exchange drawn upon it and growing out of transactions involving the importation or exportation of goods having not more than six months' sight to run; but no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half its paid up capital stock and surplus.

Any Federal reserve bank may discount acceptances which are based on the importation or exportation of goods and which have a maturity at time of discount of not more than three months, and endorsed by at least one member bank. The amount of acceptances so discounted shall at no time exceed one-half the paid up capital stock and surplus of the bank for which the rediscounts are made.

The rediscount by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations and regulations as may be imposed by the Federal Reserve Board.

The power of a bank to accept a draft or bill of exchange enables it to make use of and to sell for a consideration its credit, and so lend, for legitimate use in trade, vast sums without depleting its reserve or impairing its capability for making additional loans and advances to its clients.

While the act permits member banks to accept bills of exchange they are not at present authorized to extend such facilities to clients for the acceptance of drafts covering domestic transactions, although the state banking law in New York gives permission to state banks and trust companies to extend these facilities for both foreign and domestic transactions. This is likewise the case in Maryland, Utah, Vermont and Texas—the latter restricted to foreign acceptances only—but the laws of other states carry no provision for banks extending to their customers the use of their credit in the development of commercial relations and it would seem apparent that state bank legislation throughout the United States should be amended to harmoniously conform to the new and better system.

The New York banking law of April 16, 1914, provides that banks and trust companies under supervision of the State Banking Department, are permitted

> To accept for payment at a future date, drafts made upon them by their customers and issue Letters of Credit, authorizing the holder thereof to draw drafts upon them or their correspondents at sight or on time, not exceeding one year.

The business of banking under the present law and sphere of activity, therefore, embraces principally the function of collecting—lending capital and extending credit, which latter is not easy to overestimate in its advantages to commerce and civilization.

Amendments to the Federal Reserve Act of a technical nature designed to strengthen the system are being considered by members of the Federal Reserve Board, and will in all probability be laid before Congress at its next session. One of the proposed amendments would change the law so that acceptances, based upon domestic and commercial transactions, might be handled by federal reserve banks.

The Federal Reserve Act is essentially intended to bring into existence a commercial banking system to assist in the financing of our internal and external trade and provide a market for commercial acceptances based upon the importation and exportation of goods, at the same time providing for an automatic registration of such operations, which is a very vital feature to prevent over-extension of credit. In the case of time bills of exchange drawn on and accepted by banks or bankers of high standing, there is practical uniformity of security, which cannot be claimed for "commercial

paper" with which the financial markets here are supplied, the strength of such obligations depending upon the standing of miscellaneous commercial interests.

While we cannot hope to see the New York or San Francisco bill of exchange take the place of the so well and favorably known bills on London, Hamburg or Paris, recent events and dislocation of the financial structure in Europe have at least brought the possibility before the commercial world and tended to bring within our reach the power of competing on terms of equality with our European contemporaries.

A merchant, for instance, instead of borrowing cash on a note from his banker may arrange—for a stipulated commission charge—to use the bank's credit for a certain length of time and a given amount. To make use of such facilities a time draft may be issued against the bank, which in turn gives the required acceptance. After this requisite has been secured the merchant is in position to either use the bill of exchange in the settlement of his trade obligations or sell the same through a bill broker in the open market and so obtain available cash. The small merchant's paper, endorsed by his bank, is as acceptable as that of the largest merchant or corporation, backed as it is by security of the bank and therefore readily discountable by virtue of its high intrinsic security, as the most liquid form of investment.

It is in this class of paper that the country banks will in future invest their surplus funds, and it is gratifying to note that the federal reserve banks already have purchased as an investment some $14,000,000 of such bills—both with and without the endorsement of member banks—for under the law they can deal in acceptances of firms, corporations, individuals, foreign and domestic banks, even though they are not secured from their members.

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SECTION 14. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the endorsement of a member bank.

Every Federal reserve bank shall have power to establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign coun-

tries, appoint correspondents and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling and collecting bills of exchange, and to buy and sell, with or without its endorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signatures of two or more responsible parties.

Time bills of exchange form a considerable proportion of the reserves of the great banks in Europe.

The matter of a ready discount market, comparing favorably with prevailing conditions in principal centers abroad, is worthy of very serious consideration and while the feature of discount and rediscount provided for in the Federal Reserve Act may, in the main, be regarded as in the nature of a safety measure, it is hoped that as a principal aid to a more liberal system of financing our domestic and foreign trade, the American market may effectively adjust its rates to conform with those prevailing in other financial centers of the world.

Of course, the value of money apart from the question of whether the open market rate of discount is slightly under or slightly over the Federal reserve bank rate, will be governed by the strength of that institution, and the prospect of a demand upon its stock of gold reserve, as is the case with our British friends and their relations with the Bank of England.

Single-name paper will not create a discount market as we find them in London, Paris and Germany, where the fluctuations of rates so largely depend on the demand for and supply of marketable bills of exchange, which owe their origin to trade transactions as balanced against the demand for and supply of money. Low discount rates are an incentive to the revival of trade, and advancing rates in turn act as a natural check on trade and produce a gradual increase or decrease in the demand for money.

While these conditions are symptoms in governing the discount rates in Europe, our "call loan" rate as quoted in our Eastern markets has only an indirect relation to trade conditions, and registers mainly the speculative demand for stocks.

It is apparent that it will require something more than the offering of goods to build up and hold the trade that we are now in position to control by reason of the temporary trade inactivity of our European contemporaries who are at present using their energies

of useful production in trade and commerce to the mechanism and work of destruction.

On the efficiency of the Federal Reserve Act must depend to a large extent the prospects of a great and favorable change in the international position of the United States which will now enter into the competitive field of operations of other great financial nations.

The export trade from all ports of the United States during the fiscal year just ended—eleven months of which were within the period of the European War—attained the amazing total of over $2,700,000,000 or approximately $1,100,000,000 more than the value of our imports.

These increased figures are largely covered by our exports to European countries—with a continuous balance of trade running very heavily in our favor—and the unsettlement of foreign exchanges is consequently a matter for serious consideration, which at present is uppermost in the minds of our commercial and financial interests.

When we consider that the *Gold Par Values* of the three principal exchanges are quoted respectively as $4.86,656 for the English pound sterling, Frcs. 5.18,26 (value of $1.00) for the French franc, $0.95,2852 (value of Mks. 4.00) for the German Reichsmark, and that during the first few months—succeeding the start of the European War—our merchants have been called upon to effect liquidation at $5.00 to $6.00 for the pound sterling, 20c ($5.00) for the French franc and 24½c (0.98) for the German mark; with the problem before us of an equal unjustified decline in these exchanges, when banks have been selling the pound sterling at 4.50, francs at 6.04 and reichsmarks at 0.81—it should prove of particular concern to the commercial interests in this country and not a difficult matter to convince our European connections that the time is opportune for making the *United States Dollar* the basis of future transactions. It should be the earnest endeavor of every merchant and banker in our country to give the *American Dollar* the place it deserves in our international trade.

It would, in my opinion, require enormous resources and especially intimate credit arrangements with our foreign financial contemporaries, to maintain here a more orderly and stabler market for their exchanges—taking into consideration the hundred million or

more of favorable monthly trade balance which the United States is now enjoying. While the present low exchange levels will materially affect the interests of our exporters, the heavier burden will later descend upon the importers in foreign countries, who will be obliged, if my conception is clear, to provide for payment in *American Dollars* to cover future purchases.

It may be of interest here to show how under present conditions a shipment, for example, of coffee from Guatemala, may be financed in United States dollars over New York or San Francisco, instead of London, Paris or Germany, as heretofore.

The shipper in Guatemala is not in a position, we will say, to await the arrival of the shipment in the United States and the corresponding reimbursement, before receiving in cash the amount of his invoice, and, on the other hand, the purchaser here is unable, for various reasons, to effect payment before the goods arrive and until they have been paid for by his customers.

A "commercial letter of credit" is, therefore, suggested and supplied by his local bank, which authorizes the shipper in Guatemala to draw against the issuing bank in this country, or its correspondent in New York, San Francisco, New Orleans, etc., say at ninety days sight, with shipping documents attached to cover the value of shipment.

The letter of credit is delivered to the merchant here against the usual guarantee, and he in turn forwards the same to the shipping firm in Guatemala with the necessary instructions to effect shipment within a specified time, also stated in the credit, as well as the manner in which the insurance is to be cared for.

Immediately upon receipt of this instrument the shipper arranges to forward the coffee, obtains the required set of bills of lading, invoices and insurance certificates, and takes the same to his local banker who prepares a bill of exchange in terms with the credit. The issuance is then negotiated and the shipper receives his money. The Central American banker subsequently forwards the bill of exchange and documents to his agent in the United States who secures the necessary "acceptance" after which the bill is held for maturity, or discounted, as may best suit the interests of the negotiating bank in Central America. Upon acceptance of the bill, the bank here giving that requisite, retains the documents to be later delivered to its client under what is termed a "trust receipt,"

and after defraying the amount of duties, the interested party obtains possession of the coffee. Upon date of maturity of the acceptance, granting that it was given in San Francisco, or five days prior if credit was issued in San Francisco with drafts payable in New York, the amount is collected from the client who is also called upon to pay the usual commission charges, and in this manner the negotiation is concluded.

It is opined that we as a nation cannot successfully develop our foreign trade so long as it is necessary for us to operate through banking institutions of competing countries, and while the Federal Reserve Act provides for the establishment by member banks of branches in foreign countries, it is felt that few banks care to assume the risk separately.

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SECTION 25. Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such regulations as may be prescribed by the said board, for the purpose of securing authority to establish branches in foreign countries or dependencies of the United States for the furtherance of the foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the place or places where the banking operations proposed are to be carried on, and the amount of capital set aside for the conduct of its foreign business. The Federal Reserve Board shall have power to approve or to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate, or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authority to establish foreign branches shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the account of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each branch as a separate item.

A bill will probably be introduced in Congress in December, providing that member banks may coöperate for the purpose of jointly owning and operating foreign banks.

Jointly owned foreign banks would appear to best serve the requirements of the country as a whole. Coöperation thrives best

where action through association is legally possible and practically safe.

We are all aware that there is an undoubted tendency on the part of our commercial element to secure, if possible, an enlargement of the functions performed by banks. It is possible that the conservatism natural and proper to bankers leads them to view such a tendency with undue suspicion, but just as the conception of a banker's function has been vastly widened since the days of old, so the process will continue in the days that are to come. Developments of this kind are healthy, and wise men will not be disposed to obstruct them. A nation that would prosper in international trade must first become a world banker and the wealth and power of this country entitles it to a position of leadership in every market.

A combination of circumstances and forces, economic, political and moral, is bringing our people each day to a fuller realization of the part we are called upon to play in giving to the world an example of the possibility and practicability of international coöperation.

As the United States of America enters into the international arena, it becomes more and more apparent that national solidarity should be carefully built up and consistently nourished. Our country is larger than any national unit which has ever taken a part in the world's history. It appears to me that our problems will consequently be greater and that they will require a sounder and more consistent study than it has been necessary to devote to our problems during the rich days of our youthful and almost boundless development. When we face the markets of the world, there should not be a western or an eastern point of view to be met by our foreign customers. We should be united, not merely in our loyalty to the flag, but in the intelligent understanding of all the fundamentals of our business and economic life.

May I affirm, in conclusion, that if our people have the commercial sagacity to recognize the drift of events and to act in accordance with the spirit of the times, there ought to be no serious difficulties in bringing about an expansion of foreign trade relations that will give us a far more potent influence than this country has ever before exercised in the councils of the nations and so become a powerful factor in the maintenance of international peace—which for every country is the greatest of all achievements.